

MICHIGAN CITIES, VILLAGES, TOWNSHIPS AND COUNTIES WITH A BOND RATINGS

Adrian	Montague	Alpena Township
Albion	Mount Clemens	Alpine Township
Alma	Muskegon City	Benton Charter Township
Bay City	Newaygo	Brownstown Charter Township
Belding	Niles	Kimball Township
Belleville	Oak Park	Lansing Charter Township
Burton	Owosso	Mackinac County
Dearborn	Port Huron	Mancelona Township
Dowagiac	Romulus	Muskegon Charter Township
Durand	Roseville	Redford Charter Township
East Tawas	South Haven	South Haven Charter Township
Eastpointe	Southgate	Van Buren Charter Township
Eaton Rapids	Springfield	
Flat Rock	St. Ignace	Genesee County
Fremont	Sturgis	Hillsdale County
Garden City	Trenton	Iron County
Gaylord	Wayland	Montcalm County
Grand Ledge	Wayne	Oceana County
Hazel Pk City	Westland	Ogemaw County
Houghton	Wyandotte	
Imlay City	Ypsilanti	
Iron Mountain		
Ishpeming	Elk Rapids Village	
Jackson	Fowler Village	
Lapeer	Holly Village	
Linden	Jones Village	
Lowell	Oxford Village	
Manistee	Pigeon Village	
Menominee	Romeo Village	
Monroe		

Rating Agency Positions on Pension Obligation Bonds

To quote the rating agencies:

"**Moody's** believes the issuance of pension obligation bonds (POBs) is one effective way of addressing an unfunded liability, their issuance is not by itself a credit weakness. However, the planning and analysis conducted by a local government as part of the decision to grant expanded benefits, the government's plan for funding any unfunded pension liability, and its ability and willingness to budget appropriately for any attendant higher costs, are reflective of the quality of the government's overall financial management. These factors, therefore, will be considered in our assessment of a government's general credit quality."

"**Standard & Poor's** factors the effects of a pension obligation bond strategy into the longterm rating of the sponsor. Standard and Poor's has viewed POBs as a strategy for savings on carrying charges as long as the transaction was structured conservatively and the assumptions were reasonable and attainable. This requires a clear financing plan including reasonable assumptions and manageable leverage. Prudent expectations for investment returns and cautious use of resultant savings help insure a POB's success. Another positive factor for a POB is, of course, to be fortunate enough to sell the bonds in a low interest rate environment, thereby increasing the spread between interest costs and investment return expectations and lowering the risk of underperformance."

"**Fitch** believes that POBs, if used moderately and in conjunction with a prudent approach to investing the proceeds and other pension assets, can be a useful tool in asset-liability management. However, a failure to follow balanced and prudent investment practices with respect to POB proceeds could expose the sponsor to market losses. Because a sponsor's unfunded pension liability is already factored into the rating, the issuance of POBs simply moves the obligation from one part of the balance sheet to another. However, Fitch notes that POBs create a true debt, one which must be paid on time and in full, rather than a softer pension liability that can be deferred or rescheduled from time to time during periods of fiscal stress. Consequently, POBs can have a significant effect on financial flexibility over time" (Davis, 2003).

MOODY'S RATING METHODOLOGY: US LOCAL GOVERNMENT GENERAL OBLIGATION DEBT

Local Governments Scorecard Factors and Weights for the City of Owosso, Michigan

Bond Rating Factors	Factor Weighting	Rating Subfactors	Subfactor Weighting	Owosso
Economy/Tax Base	30%	Tax Base Size (full value)	10%	A
		Full Value Per Capita	10%	Baa
		Wealth (median family income)	10%	Baa
Finances	30%	Fund Balance (% of reserves)	10%	Aaa
		Fund Balance Trend (5-year change)	5%	A
		Cash Balance (% of revenues)	10%	Aaa
		Cash Balance Trend (5-year change)	5%	A
Management	20%	Institutional Framework	10%	
		Operating History	10%	A
Debt/Pensions	20%	Debt to Full Value	5%	Aaa
		Debt to Revenue	5%	Aaa
		Moody's-adjusted Net Pension Liability (3-year average) to Full Value	5%	Aaa
		Moody's-adjusted Net Pension Liability (3-year average) to Full Revenue	5%	Aaa



City of Owosso

301 W. Main Street
Owosso, Michigan 48867
(989) 725-0569
donald.crawford.ci.owosso.mi.us

DATE: September 11, 2014

TO: Committee Financial Liability Reform
Chair Earl Poleski

FROM: City of Owosso
Benjamin R. Frederick, mayor
Donald D. Crawford, city manager
Richard C. Williams, finance director

SUBJECT: House Bill 5279 amending MCL 141.2518(10) Public Act 34 of 2001 adding section 518 (MCL 141.2518) by Public Act 329 of 2012

INTRODUCTION:

The city of Owosso supports HB 5279 allowing communities with an underlying credit rating of A or higher or the equivalent assigned by a nationally-recognized rating agency to bond for pension obligations. HB 5279 also requires A-rated communities to provide credit enhancement in the form of bond insurance, which provides additional security and a secondary source of payment. Providing insurance on a bond offering improves the credit quality of the issue, resulting in an upgrade to the underlying credit rating. Owosso supports this provision as well.

The city of Owosso meets all the requirements of section 518 except for criteria found in paragraph 10 requiring a municipality to be assigned a credit rating of AA or higher or the equivalent by at least one nationally-recognized rating agency. When one looks at the rating criteria, Owosso is highly rated with respect to financial condition, management practices of the governing body and administration, and debt structure. The city loses because of demographic factors (age of residents, income of residents, housing values and ability to grow physically) and economy (rural, employments, lack of diverse manufacturing, and simply being in Michigan).

BACKGROUND:

The city of Owosso closed its defined benefit retirement program to all new entrants in July 2006. The effect of closing a defined benefit plan accelerates the amortization of the unfunded liabilities, driving up the annual required contribution. Owosso's annual contributions have

moved from \$390,599 in 2010 to \$808,515 in 2014. This level of contribution is expected to continue for the next 15 years and impairs the city's ability to fund general operations like public safety.

The city's pension plan is funded at 89.1% with an unfunded actuarially accrued liability (UAAL) of \$3,907,813. With passage of HB 5279, the city would bond for the UAAL and provide the proceeds to the retirement system to be invested. The relief to general purpose general operations is provided by the expected spread between the net interest cost of the bond offering and the investment returns of the retirement system. Past investment returns are not guaranteed but historical average returns provide a very comfortable margin between the borrowing rate and the investment rate.

Owosso has three pension plans. First is the City of Owosso Employee Pension Plan, covering most employees employed before 2006 and current fire and police officers. Second is the MERS plan that covers the police command. Third are defined contribution plans covering employees (except fire and police) employed after 2006.

The plan we are currently concerned with is the City of Owosso Employee Pension Plan. For many years, the city made no contribution, as the actuarial projections showed that it was over funded. Then in 2006 (AFSCME implemented 7/1/2005) the plan was closed to new employees, which meant that no younger employees would be contributing and that the age of member employees would continue to increase--the average age is now 51.7 years. Then came the 2008 market crash, and the fund lost \$11,108,104 in value while the number of employees retiring increased (four in 2009, five in 2010, eight in 2011, four in 2012, six in 2013). In addition, the city permanently laid off five employees. Thus, new actuarial studies showed that the mandated city contribution had to increase as follows:

- 2010--\$390,599
- 2011--\$550,684
- 2012--\$829,038
- 2013--\$701,388
- 2014--\$808,515
- 2015--\$810,348

The ability to bond would reduce the annual amount by about 50% or \$400,000 annually for the next 15 years.

CONCLUSION:

Owosso has been fiscally prudent by closing the defined benefit pension plans and moving to defined contribution plans. The city does not offer post-employment benefits like health insurance. Because of this prudence, the city is penalized by being unable to restructure the pension liability created in a past day when the city and state were thriving, resulting in reduced services to city residents.

Date: November 12, 2014
To: Committee on Financial Liability Reform
From: George Brown
City Manager
City of Monroe
Subject: House Bill 5279

Dear Representatives:

Please consider this communication as a request and encouragement for your support of H.B. 5279, which would amend the Michigan Municipal Finance Act to allow municipalities with "A" and "A+" bond ratings to finance unfunded, accrued liabilities for their closed defined pension and retiree health care plans.

The City of Monroe, like a number of other, older Michigan municipalities, has implemented a number strategies to responsibly right-size and reconfigure our operations. Among other things, over the past several years the City has reduced its full-time work force by 34%, modified and reduced the costs of its pension programs and closed its retiree healthcare, defined benefit program to new-hires. However, the legacy costs of some of the City's previously implemented pension and post retirement health care programs are measurably and negatively impacting the City's ability to provide current residents, businesses and institutions with essential municipal services, including public safety.

The Monroe City Council, its City's management team and its employees have displayed an ongoing commitment to live within our means, while still proving quality services. The City has an A+ bond rating and has been budgeting and funding its actuarial-determined, annual required contributions for its pension and retiree health care funds, for a number of years. The ability to consider the option of selling bonds at historically low interest rates, to fully fund the gap in accrued liabilities, would help the City to stabilize and smooth future budgeting outlays for this purpose.

Again, we are respectfully requesting that you support H.B. 5279.

Thank you for your consideration.